

Licensing Committee Team #2
Interim Report to the Licensing Committee
June 24, 2007

Mandatory Errors & Omissions Insurance for Arizona Real Estate Licensees

Licensing Committee Team #2 has reviewed the subject of mandatory E&O insurance for Arizona real estate licensees, and respectfully recommends that the ADRE Licensing Committee further consider a mandatory E&O legislative proposal. Specifically, the Team recommends:

1. A state operated E&O pool, the administration of which is completely supported by the E&O fees.
2. Pool administration through a third party administrator, with negligible financial impact on ADRE's budget.
3. Ability for licensees to obtain same levels/limits of E&O through other carriers, instead of insuring through the pool.
4. Proof of insurance prior to activating license.
5. Mandatory E&O insurance parameters similar to Colorado's.
6. E&O carrier required to report all claims to ADRE for follow-up by Investigations, as appropriate.

Consensus of Team #2

The consensus of the Team members is that mandatory E&O has significant potential in protection of the public interest. E&O insurance is generally considered an essential element of the real estate business model. Further, to the extent that E&O can be more universally acquired, the public interest is better protected, and licensees in general will be better protected.

However, three concerns surfaced. One, if mandatory E&O is adopted in such a way as to administratively burden ADRE at a time when it is suffering from a shortage of legislative funding, then it may not be an appropriate policy to pursue at this time. However, if mandatory E&O can be adopted so that the administrative costs are covered by the E&O fees, then the proposal is more acceptable. Secondly, some concern was evidenced that the existence of an E&O policy will encourage lawsuits, and that if broker supervision were better, there would be fewer lawsuits. Thirdly, it was speculated that if real estate licensees were covered by an E&O insurance policy, that they might be less diligent in their conduct of real estate.

The first concern was taken seriously by the Team and integrated into the Team's recommendation. However, the second concern, although not an uncommon belief, appears to be anecdotal in nature and unsupported by any evidence. The third concern is also anecdotal and unsupported by evidence.

Some Underlying Considerations and Assumptions

In no particular order of priority, the following are a collection of underlying considerations and assumptions:

1. Many AZ brokerages go bare of E&O. Perhaps 75% or more go bare, mostly sole proprietor brokers.
2. Civil lawsuits against licensees are rampant.
3. E&O costs are often very high.
4. The 12 (now 13) states with mandatory E&O are satisfied with it. Regulators are generally embrace mandatory E&O as a significant protection of the public interest. Licensees in those states are less enthusiastic but in overwhelming majority still endorse mandatory E&O.
5. In AZ, E&O is obtained at the brokerage level. E&O policies may not be available for individual licensees, even if individual licensees desired it.
6. Some industry sectors frequently do not have affordable E&O available to them. Exclusive business brokers, home builders and brokerages with claims history are examples.
7. Mandatory E&O only works if all licensees are insured. There cannot be a way for active licensees to opt out.
8. The additional cost of E&O, however modest, will likely cause a significant attrition of the number of licensees, mostly part-timers.
9. Most lawsuits against licensees are under \$100,000. Coverage in the other 12 states is typically \$100,000 per transaction and \$300,000 per licensee.
10. Mandatory E&O is cheap – \$150 to \$250 for annual premiums.
11. With mandatory E&O, where each active licensee has a policy under which the public can sue, brokers may feel much freer to do their jobs. Licensees might be held more directly responsible for their own acts.

Additional Resource Materials

<u>Internet Information Source</u>	<u>Attached Resource Materials</u>
<p>More general information on mandatory E&O may be obtained through this web site:</p> <p>http://www.risceo.com/index.htm</p>	<ol style="list-style-type: none"> 1. Ohio E&O Study (mandatory reading) 2. Ed's Colorado E&O Cert 3. Colorado E&O Coverage Summary 4. ARELLO E&O Study 5. The Colorado Mandatory E&O Act 6. Colorado E&O Rules 7. Wyoming E&O – WAR 8. Wyoming E&O – Wyoming Commission 9. Wyoming SF 139 – New E&O Statute

Respectfully submitted,
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